

Testimony of
Mark Chandler, Senior Vice President and General Counsel, Cisco Systems
**“Perspectives on Patents: Post-Grant Review Procedures and Other
Litigation Reforms”**
before the
Subcommittee on Intellectual Property
Senate Committee on the Judiciary
May 23, 2006

Chairman Hatch, Senator Leahy, and members of the Subcommittee, my name is Mark Chandler and I am Senior Vice President and General Counsel of Cisco Systems. Thank you for the opportunity to appear before you today to discuss this important issue.

Cisco was founded 22 years ago by two computer scientists at Stanford University who wanted to exchange information between different computer systems located on the same college campus, a feat that was virtually impossible at the time. Today, thanks to the innovation of those two and many others, the globe is interconnected through a world wide web that changes the way all of us live, work, play and learn.

Originally our products were designed for communications within private or enterprise networks. When the public Internet emerged in the mid '90s, our products found immediate application for worldwide use. Networking equipment forms the core of the global Internet and most corporate and government networks. When you send an email in your office to your children or grandchildren, the digital language that makes up that email is routed through equipment made by Cisco or our competitors. Cisco makes the equipment that makes the Internet work.

Much of the value of our company rests upon the intellectual property embodied in our networking products – both hardware and software. We hold over 2,500 issued US patents and have applied for over 4,000 more. Cisco therefore believes deeply in strong protection for intellectual property. We believe that fair litigation rules are essential to allow us to protect this key element of our company's value.

So why would a company like Cisco favor rules changes that some charge would decrease the value of patents? And why would a company like RIM, creator of the Blackberry that so many depend on today for daily commerce, pay more than \$600 million to license patents that the Patent Office has said are likely invalid?

The answer to these questions is that our patent litigation system is broken.

Increasingly, companies like Cisco and RIM that manufacture products or offer services are being named as defendants in a new type of patent infringement litigation. These actions, often brought in obscure jurisdictions, virtually never involve situations in which a patentee or an exclusive licensee of the patentee seek to preclude anyone else from practicing the invention in order to retain for themselves all of the economic benefit associated with commercializing the patent. Rather, the patentee in these cases is willing to enter into licenses broadly; indeed, the patentee often sends letters to fifty or one hundred companies at a time offering to license its patent, and threatening an infringement action against any recipient that refuses to enter into a licensing agreement; one plaintiff sent such letters to **75,000** companies.¹ At least sixty-five entities claim that wireless access to the Internet can only be achieved under the “Wi-Fi” standard by using their patents.²

Justice Kennedy recognized this new phenomenon in his opinion in the Supreme Court’s *eBay* decision last week: “[i]n cases now arising . . . the nature of the patent being enforced and the economic function of the patent holder present considerations quite unlike earlier cases. ***An industry has developed in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees***” (emphasis added).³

When a patentee is willing to enter into a license, and the only issue is the price that will be charged for the license, our patent system should encourage negotiation of a reasonable license fee that reflects the fair market value of the intellectual property. The rules of the litigation system should not supply undue leverage to one side or the other. When that is the case, litigation will be the exception, as clearly defined rules will allow the parties to reach agreement on a fair license fee. In that environment, innovation can thrive because economic actors have a high level of certainty of their rights and obligations.

Our current patent litigation system falls far short of this standard. The litigation rules themselves encourage buying old patents rather than funding development of new inventions and innovations. These rules incentivize forum shopping and winner-take-all, jackpot-like litigation strategies, where leverage flowing from litigation standards, rather than economic value in any real-world sense, drives actions and results.

The ability to invoke the litigation system, and to take advantage of rules that tilt the playing field decidedly toward the plaintiff, greatly enhances the patent holder’s negotiating leverage regardless of the strength of either the underlying patent or the infringement claim being

¹ For example, RIM’s CEO testified that the plaintiff in the infringement action against it sent such letters to 47 companies. *Patent Quality Enhancement in the Information-Based Economy: Hearings Before the Subcomm. on Courts, the Internet and Intellectual Property of the H. Comm. on the Judiciary*, 109th Cong., (Apr. 4, 2006) (testimony of James Balsillie, Chairman and CEO, Research in Motion). Another example is “the company E-Data, which sent letters to 75,000 companies informing them that they were infringing an E-Data patent and asking them to pay royalties between \$5,000 and \$50,000. The company owns a patent which arguably covers financial transactions on the Internet. Several high-profile companies agreed to license the patent but most refused. E-Data sued forty-one of the companies for patent infringement.” Meurer, “Controlling Opportunistic and Anti-Competitive Intellectual Property Litigation,” 44 B.C. L. Rev. 509, 517 (2003).

² See IEEE Standards Association, 802.11 Patent Letters of Assurance, at http://standards.ieee.org/db/patents/pat802_11.html.

³ *eBay Inc. v. MercExchange LLC*, No. 05-130 (May 15, 2006), slip op. 2 (Kennedy, J., concurring, joined by Stevens, Souter, and Breyer, JJ.).

asserted. Rather than providing a neutral mechanism for resolving disputes, the patent litigation rules themselves are now a key means of enhancing patent value. Justice Kennedy recognized one aspect of this phenomenon, citing the leverage exercised by plaintiffs “[w]hen the patented invention is but a small component of the product the [defendant] companies seek to produce.”⁴

The prevalence of this phenomenon of using litigation rules to coerce large license payments is demonstrated by the growth in the number and scope of patent infringement claims. Nationwide, the number of patent cases more than doubled between 1991 and 2001,⁵ and have increased every calendar year since then based on the statistics released by the Administrative Office of the United States Courts – the number of patent cases in 2005 was more than 19.5% greater than the number in 2001.⁶ In Marshall, Texas alone, where only 7 patent cases were filed in 2003, 116 patent cases have been filed in the last 16 months.⁷

Even more significant is the growth in the size and scope of these cases – the amounts of money at issue in infringement actions are much greater than ever before, and the typical case involves claims against numerous companies:

- prior to 1990 there had been only one patent damage award in history larger than \$100 million;⁸ over the next ten years (from 1990 through 1999) there were 13 judgments and settlements in that category, and in the next six years (between 2000 and 2005 there were 21, including one award for \$1.35 billion – the increasing number of gigantic cases is readily apparent;⁹
- the number of companies caught up in this litigation is large and growing: for example, the 218 infringement actions filed in Marshall, Texas, during the 28 months from January 2004 through April 2006 named 856 defendants, including more than 600 separate companies (some companies were named in more than one action).¹⁰

The perverse result is that the very laws intended to promote innovation actually are deterring innovation. The additional costs – in both legal fees and unjustified extortionate settlements – “create[] a substantial ‘innovation tax’ that afflicts some of America’s most important and creative firms” and, by extension, their customers.¹¹

⁴ *Id.*

⁵ William O. Kerr and Gauri Prakash-Canjels, *Patent Damages and Royalty Awards: The Convergence of Economics and Law*, in *les Nouvelles*, June, 2003, at 83

⁶ Data compiled from Table C 2, U.S. District Courts - Civil Cases Commenced, By Basis of Jurisdiction and Nature of Suit During the Twelve Month Periods of Dec. 31 to Dec. 31 (2000-2001, 2001-2002, 2002-2003, 2003-2004, 2004-2005).

⁷ Chuck Lindell, “A Litigation Boom,” *Austin American-Statesman* (Apr. 16, 2006), at A10; PACER System for the United States District Court of the Eastern District of Texas. (identifying eight cases filed between April 13 and April 30).

⁸ William O. Kerr and Gauri Prakash-Canjels, *supra*;

⁹ Internet Patent News Service & Source Translation and Optimization Co., Table of Patent/copyright infringement lawsuits/licensing awards, at <http://www.iplaw-quality.com/economic/awards.htm>

¹⁰ PACER System for the United States District Court of the Eastern District of Texas (statistics based on a review of complaints filed between January 1, 2004 and April 30, 2006).

¹¹ Adam B. Jaffe & Josh Lerner, *INNOVATION AND ITS DISCONTENTS* 16 (2004).

As a result, a company creating a new product must consider whether that product will be sufficiently profitable to cover not only development and production costs, but also potential settlement payments on unjustified infringement claims. The risk of infringement lawsuits will cause some firms “to avoid the mine field altogether, that is, refrain from introducing certain products for fear of holdup.”¹² That deters innovation and thereby inflicts significant damage upon our entire economy.

Relatively recent changes in patent litigation rules have transformed the system from a fair forum for resolving disputes into a source of settlement leverage for plaintiffs, enabling them to force large payments without regard to the merits of the underlying patent claims. The litigation system needs serious reform to allow the free market to operate without the influence of litigation-driven leverage. That is why Cisco and a number of other technology, manufacturing, media and financial services companies have joined together in the Coalition for Patent Fairness, which seeks to reform the patent litigation system.

In my testimony today I would like to address three issues: the importance of effective post-grant review procedures, the impact of the Supreme Court’s decision last week in *eBay*, and the other litigation reforms necessary to restore balance in the patent litigation system.¹³

Post-Grant Administrative Review

The quality problems in the patent process are broadly recognized.¹⁴ It is simply impossible for an examiner – in the limited time available and without the benefit of an adversary presentation – to identify and analyze all relevant prior art and to ensure that any patent that is granted is properly limited. This is true with respect to any sector, but it is especially true with respect to patent applications in highly technical areas.¹⁵

¹² Carl Shapiro, *Navigating the Patent Thicket: Cross Licenses, Patent Pools, and Standard Setting*, in 1 INNOVATION POLICY AND THE ECONOMY 119, 126 (Adam B. Jaffe et al. eds., 2000).

¹³ Providing additional resources to the PTO in order to improve the patent examination process also will help address these problems. Cisco supports ensuring adequate funding for the PTO by ending the practice of diverting patent fees, which will allow the agency to hire more examiners and provide better training. In addition, there should be a mechanism to allow members of the public to submit prior art and other information relevant to patentability, together with commentary on that art and information, so that the examiner’s decision may be based upon the best possible prior art information. Finally, Cisco has submitted comments in support of the PTO’s proposed changes to limit the filing of continuations, and we encourage the Congress to adopt reforms to end abuses of the continuation process as well.

¹⁴ These quality issues have been discussed by both the National Academy of Sciences and the Federal Trade Commission. See Nat’l Academies, Nat’l Research Council, A PATENT SYSTEM FOR THE 21ST CENTURY 37 (Stephen A. Merrill et al. eds., 2004); FTC, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY (2003). Mark A. Lemley, *Rational Ignorance at the Patent Office*, 95 Northwestern Univ. L. Rev. 1495 (2001), at 1500 (“It is not surprising, therefore, that the PTO issues many patents that would have been rejected had the examiner possessed [technical] knowledge.”).

¹⁵ An additional problem in the software field is the fact that prior art (which is the totality of previously known technologies against which a new invention is measured to ensure that it merits a patent) is not as well documented for the computing field as it is in some other areas. In part this is because, for many years, patents were not readily available for software. It is also attributable to the nature of large-scale commercial software and computing – millions of lines of software code or billions of transistors or other components that may require significant effort to identify or understand. This makes the task of the patent examiner difficult: she must determine the patentability of software inventions without always having a complete understanding of what is already known in the art.

The primary means of challenging the validity of a patent is through litigation. (Although current law provides for an *inter partes* administrative reexamination process, that procedure is so restricted that it has little or no practical utility, and that is why fewer than 100 requests for *inter partes* reexamination have been ever been filed.¹⁶) Not only is litigation an extremely costly approach, but patent litigation rules assign a presumption of validity to any patent issued by the PTO and the decision maker in a judicial proceeding will likely be a jury that has no technical knowledge and will be influenced substantially by the existence of a government-issued patent. One study found that juries upheld the patent's validity in 71% of the cases (as compared to 64% for bench trials).¹⁷ In some jurisdictions, the rate is 90%.¹⁸ The presumption of validity thus makes the judicial process an extremely poor vehicle for correcting the issuance of patents that do not meet patentability tests.

The obvious solution to this problem is to allow effective post-grant administrative proceedings to challenge the issuance of a patent, presided over by administrative judges trained not to view the patent applicant as the agency's "client" and the agency's mandate as "issuing patents", which is the PTO's current posture, but to assess fairly whether validity objections have merit. That would place the decision-making responsibility where it belongs – with the expert agency. It would enable the agency to allocate resources to more intensive examination of patents that are a source of controversy. And it would give the agency the benefit of adversary proceedings to sharpen the issues and to provide the agency with all relevant arguments (and supporting background materials) for and against the validity of the patent.

At the same time, as the holder of over 2,500 patents, we recognize that the post-grant review process cannot unfairly burden the patent holder with dilatory, duplicative and expensive proceedings. The principle that justice delayed is justice denied applies with full force to the patent process. Our comments today take this important interest into account.

Before presenting our suggestions, a bit of background regarding the nature of the problem will be illuminating. Although it would be useful to allow an aggrieved party to seek post-grant review immediately after the issuance of a patent, a so-called "first window," that alone will not solve the quality problem. Rather, the inclusion of a "second window" triggered by receipt of a notice of infringement or patent infringement complaint is also necessary. Let me explain why with reference to the experience of technology companies like Cisco.

Technology products typically are made up of dozens – or even hundreds or thousands – of components against which a patent holder could attempt to assert a claim. Thus, computers, cellular telephones, MP3 players, as well as airplanes, cars and communications networks often contain thousands of different physical components, as well many different means of operation,

A similar problem exists with respect to business method patents. Indeed, Justice Kennedy in the *eBay* case noted "[t]he potential vagueness and suspect validity of some of these patents." Slip op. 2 (concurring opinion).

¹⁶ David Cochran, *Toward a Post-Grant Opposition Proceeding in the United States*, Mondaq Business Briefing, Apr. 21, 2006 ("[A]s of June 2005, only about 80 *inter partes* requests had been filed.").

¹⁷ Kimberly A. Moore, *Judges, Juries, and Patent Cases — An Empirical Peek Inside the Black Box*, 99 Mich. L. Rev. 365, 388 (2000).

¹⁸ Chuck Lindell, "A Litigation Boom," *Austin American-Statesman* (Apr. 16, 2006), at A10.

each of which may draw the interest of patent holders. A single computer program may contain hundreds or thousands of components or elements; a computer chip may have millions of parts.¹⁹

A technology company therefore cannot know at the time a patent is issued (the time of the “first window”) whether that patent might become relevant to the company’s business sometime in the future. Indeed, even when a technology business is developing a new device or a new computer program, it often is extraordinarily difficult – notwithstanding the business’s best efforts – to identify all of the existing patents, let alone pending patent applications, that may be relevant to each of the hundreds or even thousands of components that make up that new product.²⁰

This problem is compounded by the fact that patent holders’ subsequent infringement claims often bear little relation to the invention described in the patent and therefore cannot be anticipated by the potential defendant. For example, one patent holder claimed that the Internet service provider was infringing its patent by providing Internet access services to the ISP’s customers, where the patent described a system in which multiple users at remote terminals could access data stored centrally when in reality the ISP only provided its customers with the ability to access the Internet.²¹ Our own litigation experience indicates that there simply is no way to anticipate the far-fetched arguments that some patent holders will advance in attempting to stretch the coverage of their patents. By the time a defendant is even made aware that a patent holder will attempt to make an infringement claim, a first window will be useless.

The “entire market value rule,” which can result in an award of patent damages based on the entire sales price of a product no matter how limited the nature of the feature which is claimed to infringe (an issue discussed in greater detail below), provides patent holders with a strong incentive to bring such claims in an attempt to capture that windfall. Even when the subject matter of the patents, if infringement were to be found, would cover an obscure aspect of a product, with no apparent economic value, damages assessed on a very large revenue base could result.

For these reasons, limiting post-grant review to the period immediately after the grant of the patent will doom the post-grant process to irrelevancy. It is essential that a “second window” for post-grant review be triggered by the receipt of a notice of infringement or of a patent infringement complaint.

To avoid unjustified burdens on the patent holder, we therefore suggest that the “second window” be circumscribed with reasonable limitations to eliminate any potential unfairness:

- if the prospective defendant chooses to initiate a post-grant review process, he or she will be estopped from re-litigating in the court action any issues **actually** raised and decided in the administrative proceeding and subsequent action for judicial review, so long as the

¹⁹ Nat’l Academies, Nat’l Research Council, A PATENT SYSTEM FOR THE 21ST CENTURY 37 (Stephen A. Merrill et al. eds., 2004).

²⁰ FTC Report, Ch. 2, at 28.

²¹ The claim was rejected in *British Telecommunications PLC v. Prodigy Communications Corp.*, 217 F. Supp.2d 399 (S.D.N.Y. 2002).

post-grant review process allows for discovery and argument analogous to that available in court;

- if the prospective defendant chooses not to initiate an administrative proceeding, then any challenge to the validity of the patent in the court action must overcome the presumption of validity;
- a patent holder may choose not to allow initiation of a “second window” administrative proceeding, but in that case the presumption of the patent’s validity would not apply in any subsequent infringement action (for small inventors, we suggest that the PTO establish an office to defend the validity of patents whose owners lack the resources to do so).

Such a procedure would provide defendants with an incentive to challenge the validity of a patent before the expert administrative agency – the decision maker that, because of its technical expertise, is most likely to render a correct decision when fully informed of the relevant facts. It also will avoid the bizarre situation in which the PTO announces tentative determinations that particular patents are invalid at the same time a court is awarding damages and considering injunctive relief on the basis of its findings of validity and infringement of the very same patents. And there is no risk of duplicative litigation, because any issue actually raised and decided in the administrative proceeding cannot be relitigated in court. Strict time limits and penalties for delay should be included to ensure that the administrative proceeding is not used to thwart legitimate infringement claims.

The current *inter partes* review procedure has failed because estoppel was applied not just to claims actually raised in the proceeding, but also to those invalidity grounds that could have been raised. It is essential that any second window not repeat this mistake. We believe the checks and balances described above will allow for fair review, without an overly broad *res judicata* effect and without imposing undue burdens on either the patent holder or the party accused of infringement.

The Impact of the *eBay* Decision

As the Subcommittee knows from its prior hearings on this subject, one aspect of the litigation system that enabled abusive litigation was the Federal Circuit’s standard for granting injunctions in infringement actions. Ignoring the plain language of the governing statute, that court had adopted a “general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances.”²²

The Supreme Court last week unanimously overturned that standard, holding that district courts in infringement actions must apply the traditional four-factor test for granting an injunction. The Court emphasized that “[t]he decision to grant or deny permanent injunctive relief is an act of equitable discretion by the district court, reviewable on appeal for abuse of discretion.”²³ Most importantly, the Court recognized that the system is subject to abuse by a

²² See, e.g., *MercExchange LLC v. eBay Inc.*, 401 F.3d 1323, 1339 (Fed. Cir. 2005).

²³ *eBay Inc. v. MercExchange LLC*, No. 05-130 (May 15, 2006), slip op. 2.

new class of plaintiffs and sought to correct the balance on the only issue before it: the standard for issuing injunctions.

The Court held that this conclusion followed from the language of the Patent Act, which “expressly provides that injunctions ‘may’ issue ‘in accordance with the principles of equity.’”²⁴ It also stated that “‘a major departure from the long tradition of equity practice should not be lightly implied’” and “[n]othing in the Patent Act indicates that Congress intended such a departure.”²⁵

The Federal Circuit had justified its rule requiring injunctions on the theory that a patent conferred a right to exclude that could only be vindicated through an injunction. The Supreme Court rejected this conclusion, pointing out that “the creation of a right is distinct from the provision of remedies for violations of that right.”²⁶ The statutory recognition that a patent should have the attributes of personal property – not real property – is “[s]ubject to the provisions of this title,” 35 U.S.C. § 261, including, presumably, the provision that injunctive relief ‘may’ issue only ‘in accordance with the principles of equity.’”²⁷

The Supreme Court also provided some guidance on how lower courts should apply its decision. It not only rejected the Federal Circuit’s “general rule” that an injunction is virtually always appropriate; it also rejected the district court’s “categorical[ly]” rule that a patent holder’s “lack of commercial activity in practicing the patents” and “willingness to license its patents” sufficed to demonstrate that the patent holder would not suffer irreparable harm in the absence of an injunction.²⁸ The Supreme Court stated that “some patent holders, such as university researchers or self-made inventors, might reasonably prefer to license their patents, rather than undertake efforts to secure the financing necessary to bring their works to market themselves. Such patent holders may be able to satisfy the traditional four-factor test and we see no basis for categorically denying them the opportunity to do so.”²⁹ Thus, the Court squarely rejected all broad categorical rules in favor of a fact-specific inquiry that takes account of the facts of each particular case.

Additional guidance on applying the four-factor test is provided by the two concurring opinions. Chief Justice Roberts, joined by Justices Scalia and Ginsburg, pointed out that “[f]rom at least the early 19th century, courts have granted injunctive relief upon a finding of infringement in the vast majority of patent cases” and concluded that in applying the four-factor test, “‘a page of history is worth a volume of logic.’”³⁰ Justice Kennedy, joined by Justices Stevens, Souter, and Breyer, agreed that this history is relevant, but pointed out that

[t]o the extent earlier cases establish a pattern of granting an injunction against patent infringers almost as a matter of course, this pattern simply illustrates the result of the four-factor test in the contexts then prevalent. *The lesson of the historical practice,*

²⁴ *Id.* at 3 (quoting 35 U.S.C. § 283).

²⁵ *Id.* at 3 (citation omitted).

²⁶ *Id.* at 3.

²⁷ *Id.* at 3 (citation omitted).

²⁸ *Id.* at 5, 4.

²⁹ *Id.* at 4.

³⁰ *Id.* at 1, 2 (Roberts, C.J., concurring, joined by Scalia and Ginsburg, J.J.)

*therefore, is most helpful and instructive when the circumstances of a case bear substantial parallels to the litigation the courts have confronted before.*³¹

Justice Kennedy went on to observe – as discussed earlier in my testimony – that “[a]n industry has developed in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees. For these firms, an injunction, and the potentially serious sanctions arising from its violation, can be employed as a bargaining tool to charge exorbitant fees to companies that seek to buy licenses to practice the patent.”³² District courts’ equitable discretion allows them “to adapt to the rapid technological and legal developments in the patent system” and to “determine whether past practice fits the circumstances of the cases before them.”³³

Both groups of Justices agree that when the facts and circumstances of a case resemble those of traditional patent infringement cases addressed by courts for more than a century, an injunction is likely to issue. When “the nature of the patent being enforced and the economic function of the patent holder present considerations quite unlike earlier cases,”³⁴ Justice Kennedy emphasized that courts must scrutinize the facts closely to determine whether the four-factor test is satisfied, and Chief Justice Roberts did not disagree.

For example, when a university or a small inventor grants a meaningful exclusive license to a third party that has the financial resources and business experience to practice the invention, that exclusive license is a traditional approach to practicing a patent designed to transfer to the licensee the benefits that would accrue to a patentee that practices its invention. Infringement interferes with those benefits in the same way it would if the patentee were the one exclusively practicing the invention.

The situation is quite different, however, when a patent holder is willing to issue licenses broadly to a number of participants in the market. Infringement still injures the patent holder in the economic sense because it deprives the patent holder of licensing revenues. But the patent holder’s willingness to accept license payments in return for multiple nonexclusive licenses – an unusual arrangement, as Justice Kennedy observed – provides strong evidence that money damages are likely provide adequate compensation for that injury.

Although the Supreme Court has provided excellent guidance for the lower courts, the real-world impact of the decision on the patent litigation system will become clear only when the district courts – freed of the Federal Circuit’s virtual *per se* rule requiring injunctions – begin to apply the four-factor test and those decisions are reviewed by the court of appeals. We believe that Congress should allow this process to go forward.

As positive as the *eBay* decision may be, however, the Court’s ruling will not solve all of the problems of the patent litigation system. As the *Wall Street Journal* stated last week, “taking away the threat of a crippling automatic injunction in unwarranted cases” is “progress,” but

³¹ *Id.* at 1 (Kennedy, J., concurring).

³² *Id.* at 2 (Kennedy, J., concurring).

³³ *Id.*

³⁴ *Id.*

“isn’t going to fix all that ails our patent system.”³⁵ The *Los Angeles Times* agreed: “Now that the Supreme Court has started fixing the patent morass, lawmakers need to finish the job.”³⁶ One patent attorney was even more to the point: “I don’t think patent holding companies will change their strategies. Patent litigation will be very lucrative even if injunctions can’t be obtained as readily.”³⁷

Indeed, the Supreme Court’s decision itself provides strong impetus for a number of key reforms. For example, the Court’s restoration of district courts’ equitable discretion makes it even more important to eliminate forum shopping that seeks to game the system by selecting a favorable forum notwithstanding the absence of any real connection to the litigants or matters in dispute. And four Justices recognized the unfairness of the situation in which remedies are applied without taking account of the fact that “the patented invention is but a small component of the product the [defendant] companies seek to produce.”³⁸

Given this pressing need for additional reform, I will turn next to the four specific areas in which we believe legislative action is essential in order to restore balance to the litigation system.

Other Necessary Litigation Reforms

1. Eliminate Forum Shopping

The phenomenon of forum shopping in patent litigation is well documented. One expert who has studied this phenomenon recently testified that “forum shopping is alive and well in patent cases in the district courts.”³⁹ The venue statute subjects virtually any company with national sales to suit on an infringement claim in any judicial district in the country. “Currently, patentees have the ability to sue in any of the 94 district courts – virtually unfettered ability.”⁴⁰

The “magnet jurisdiction” phenomenon – reflected in the sharp rise in cases filed in Marshall, Texas that I have already discussed – appears to be fueled in part by the perception that plaintiffs are more likely to prevail in that jurisdiction than in other courts.⁴¹ Some empirical evidence supports this conclusion.⁴²

³⁵ *Wall Street Journal*, May 16, 2006, at A14 (editorial).

³⁶ *Los Angeles Times*, May 17, 2006, at B12 (editorial).

³⁷ Erik E. Larson, “Muted Impact Seen From Supreme Court’s eBay Ruling,” *Portfolio Media*, (May 17, 2006).

³⁸ *eBay, supra*, at 2 (Kennedy, J., concurring).

³⁹ *Improving Federal Court Adjudication of Patent Cases: Hearings Before the Subcomm. on Courts, the Internet and Intellectual Property of the H. Comm. on the Judiciary*, 109th Cong., 109-59 (Oct. 6, 2005) (testimony of Kimberly A. Moore, Professor of Law, George Mason University School of Law), at 6.

⁴⁰ *Id.*

⁴¹ Alan Cohen, *From PI to IP; Texas Attorneys Transform Their Practices After Tort Overhaul*, 21 *Tex. Law.*, No. 36, at 15 (Nov. 7, 2005); M. Craig Tyler, *Patent Pirates Search Texas for Treasure*, 20 *Tex. Law.*, No. 29, at 40 (Sept. 20, 2004) (“Juries in East Texas . . . are much less likely to have a member with any technical training or education, which . . . makes East Texas federal courts an attractive venue for would-be plaintiffs, who know that the jury will, instead, gravitate toward softer or superficial issues that are difficult to predict.”).

⁴² “Since 1994, patent owners have prevailed in 88 percent of all jury trials and 75 percent of bench trials in Marshall” (Cohen, 21 *Tex. Law.*, No. 36, at 16), figures that far exceed the national averages of 68% and 51% respectively found in Moore, *Judges, Juries, and Patent Cases — An Empirical Peek Inside the Black Box*, 99 *Mich. L. Rev.* 365, 386 (2000).

Lawsuits should be resolved by a forum that has a reasonable connection to the underlying claim, and venue standards should be drawn to preclude “gaming the system” through forum-shopping. This is especially true now that the Supreme Court has restored district courts’ discretion to determine the appropriateness of an injunction: plaintiffs should not be permitted to circumvent the Court’s decision by funneling cases into courts that are predisposed to granting injunctions, just as defendants should not be able to target courts predisposed in the opposite direction.

2. Revise the Standard For Calculating Royalties/Damages

When a small component of a multi-component system or product is alleged to infringe a patent, the plaintiff’s damages claim typically is based on a percentage of the value of the entire product, rather than on a percentage of the value of the infringing feature or functionality.⁴³ This approach greatly inflates the potential damages available to a plaintiff, and provides a tremendous incentive to file infringement actions with respect to any aspect of a complex product, no matter how insignificant the contribution of the allegedly-infringing component. The amount of money potentially at stake in the litigation as a result of this rule imposes huge settlement pressure on the defendant, regardless of the strength of the infringement claim.

Congress should make clear that both damages and reasonable royalties must be calculated on the basis of the proportionate share of the value of the product that is attributable to the patentee’s contribution, rather than on the cumulative value of the entire product.

3. Prevent Suits for Worldwide Damages in U.S. Courts

Section 271(f) was added to the patent law to prevent companies from avoiding an infringement claim by manufacturing components of an infringing product in the United States and exporting those parts for assembly abroad. The Federal Circuit has interpreted the provision to apply to copies of computer programs made outside the United States if the software is made from a “master disk” developed in the United States.⁴⁴ That means that software companies may be held liable in United States courts for alleged infringement occurring outside the United States. Because these companies remain subject to suit in other jurisdictions where sales occur, they may be forced to pay twice.

This rule strongly encourages software companies to move their research and development operations outside the United States because global damages are not available in U.S. courts for software developed abroad. Congress surely did not intend that result.

Moreover, the lower courts’ erroneous construction of Section 271(f) is another litigation system-supplied incentive for plaintiffs to press abusive infringement claims. A claim for global infringement damages based solely on a U.S. patent obviously exposes a defendant to much

⁴³ *The Patent System Today and Tomorrow: Hearings Before the Subcomm. on Intellectual Property of the S. Comm. on the Judiciary*, 109th Cong., (Apr. 25, 2005) (testimony of Joel Poppen, Deputy General Counsel, Micron Technologies, Inc.) (“Damages are often vastly disproportional to the actual contribution of the supposed invention because damages are awarded based on the entire value of the product sold – even when the invention actually claimed in the patent is merely a small component of a larger, unpatented system.”).

⁴⁴ *AT&T v. Microsoft Corp.*, 414 F.3d 1366 (Fed. Cir. 2005), petition for cert. pending, No. 05-1056; *see also Union Carbide Chem. & Plastics Tech. Corp. v. Shell Oil Co.*, 425 F.3d 1366 (Fed. Cir. 2005).

greater liability than a claim limited to the United States; a plaintiff's ability to assert such a claim therefore increases its settlement leverage by threatening huge liability. This rule thus provides a defendant with a large incentive to settle regardless of the underlying merits of the infringement action.

Although this issue is now pending before the Supreme Court, and the Court has asked the Solicitor General to file a brief expressing the views of the United States with respect to the issue, we urge Congress to intervene to clarify its intent with respect to this provision and eliminate the harmful effects of this provision on the patent litigation system.

4. Reform the Standard for Willfulness

The patent law provides that a court may award treble damages and attorneys' fees if it finds that the defendant engaged in "willful" infringement.⁴⁵ Although the courts have characterized these extra-compensatory damages as a form of punitive damages, the standard applied to determine whether the defendant acted "willfully" is far lower than what is required to impose punitive damages in other contexts – proof of bad faith or egregious conduct is not required and a plaintiff may prevail simply by showing that "a potential infringer ha[d] actual notice of another's patent rights" and failed to satisfy his "affirmative duty to exercise due care to determine whether or not he is infringing."⁴⁶ This standard has the practical effect of shifting the burden of proof to the defendant whenever the plaintiff can show that the defendant had notice of the plaintiff's patent, even where the notice was received years after defendant completed development of its product.

The current willfulness standard has several negative effects. To avoid a finding of knowledge of the plaintiff's patent, too many companies now instruct their employees to avoid reading patents and patent applications. That is the precise opposite of the behavior that the system should seek to encourage.

If a company does learn of the existence of the plaintiff's patent, it may seek to satisfy its duty of care by obtaining an opinion of counsel that the patent is invalid, or the company is not infringing the patent, or both. But reliance on that opinion typically triggers a pre-trial disclosure obligation, which in turn may waive the attorney-client privilege more broadly – requiring disclosure of other materials prepared by the defendant's attorneys, even materials relating to the infringement litigation itself. The defendant therefore faces the choice of the loss of the privilege, and disclosure of otherwise-confidential material that the plaintiff may use to color unfairly the underlying infringement issue; or maintaining the privilege and sacrificing a key defense to the willfulness claim.

Given the very low burden on the plaintiff, the opportunity for treble damages, and the conundrum that a willfulness claim causes for defendants, it is not surprising that such claims are

⁴⁵ 35 U.S.C. §§ 284 & 285.

⁴⁶ *Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana*, 383 F.3d 1337, 1343 (Fed. Cir. 2004) (Dyk, J., concurring in part and dissenting in part) (citation and internal quotation marks omitted).

asserted frequently in infringement litigation. One study found that they were asserted in more than *ninety percent* of all infringement claims.⁴⁷

In addition to the ill effects already discussed, these claims provide plaintiffs with increased leverage in the settlement/license fee negotiation process. The threat of treble damages based on an indefinite and fairly low standard mean that defendants face considerable pressure to settle even unjustified claims because a huge monetary judgment can result from a loss on the merits. Reform of both the willfulness standard and the procedure for litigating willfulness claims is essential to avoid these negative effects and provide a fair balance in the litigation process.

* * * * *

Opponents of reform likely will argue that the modest proposals we support to restore balance to patent litigation will deter innovation, severely disadvantage patent owners, and eliminate longstanding rights. That simply is not true. As we have discussed, the present rules are deterring innovation. Our goal is to restore fairness to a system that has been distorted by recent judicial decisions (in the case of Section 271(f) and the damages calculation issue), illegitimate exploitation of loopholes in the system (in the case of forum shopping and willfulness claims), and the decline in patent quality (post-grant reexamination).

Moreover, the same contentions were raised by many of the same opponents in arguing that district courts should not be permitted to exercise their equitable discretion in deciding whether to grant injunctions. There were claims that application of the traditional standard for injunctive relief was inconsistent with hundreds of years of precedent in patent cases, violative of property rights, inconsistent with U.S. treaty obligations, and unnecessary to ensure fairness in patent infringement litigation. The Supreme Court unanimously rejected all of those arguments and reaffirmed the district courts' discretion. Here as well, Congress should reject these unsupported arguments and act to restore fairness to patent litigation by adopting modest reforms.

Thank you.

⁴⁷ Kimberly A. Moore, *Empirical Statistics on Willful Patent Infringement*, 14 Fed. Cir. B. J. 227, 232 (2004).